The Future of OCWA and Ontario's Water Industry

A submission prepared for the Bill 107 hearings

of the

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Part 1. Executive Overview

While only a few years old, the Ontario Clean Water Agency should more properly understood as a successor agency with a long and distinguished history. It represents the current expression of the foresight Premier Leslie Frost's Conservative government displayed in 1956 when it established the Ontario Water Resources Commission. Although the Commission was later absorbed into Ministry of the Environment in 1972, and thereby mixed with broad public policy objectives suitable for a government department, the creation of OCWA in 1993 represents a return to OWRC's roots as a business-like provincial facilitator and service provider of water and wastewater developments.

Both the transfer of provincial ownership and termination of provincial financial obligations to municipalities are at the heart of Bill 107 – the *Water and Sewage Transfer Act, 1997*. The presumed intent of Bill 107 would appear to be that OCWA should not provide services to municipalities that rightfully could look after their own needs, but OCWA has had a larger function over its forty-one years of operation. One of the principal reasons for its existence has been to be a residual provider of water and wastewater, whether in its own name or that of municipalities, for municipalities unable to look after their own needs.

This residual provider role proved necessary in the early post-war era when the provincial government decided it should step in to provide assistance to municipalities for public health and economic development reasons. And thus it has been as a result of providing services to a broad range of municipalities that OCWA has been able to assemble the critical mass of expertise to be an efficient and effective residual provider. If it had operated just in municipalities that might not otherwise have attended to their own needs, it would not have been able to establish the necessary business balance to offer the residual provider function. The demise of OCWA could result in the creation of provincial government programs with a more direct and higher cost to provincial taxpayers.

Although Bill 107 seems not to affect the broader municipal landscape, it should not be examined in isolation. The reason is that a new municipal governance environment has almost fully been put in place that has important implications for the impact of Bill 107's provisions on municipalities. As a result, the Bill needs to be examined along side the recent amendments to the *Municipal Act*, but also the proposed amendments that will give municipalities 'natural person' powers. Only in this light can the Bill's full impact on the municipal sector be determined.

The Bill 26 and Bill 86 rounds of amendments to municipal statutes – respectively, the *Savings and Restructuring Act, 1996* and the *Better Local Government Act, 1996* – removed all the requirements in the *Public Utilities Act* that the "assent of the electors" be received before dissolving public water commissions. Similarly, the same threshold requirement before privatizing water utilities under the *Municipal Franchises Act* was also removed. While alternate service delivery options should be considered by municipalities, the assent of electors provisions had originated prior to the turn of the last century precisely to permit water customers to be able to have input into who would be their monopoly provider. Public utilities became the provider of choice because of at-cost operation and mechanisms for customer input.

These amendments to the municipal governance framework are not unrelated to Bill 107 because they are the new rules for how municipalities will make decisions about the water and wastewater services they are transferred from OCWA. Moreover, when the government completes its proposed redraft of the *Municipal Act*, municipalities will be given 'natural person' powers to contract for private services as they see fit, although they could still use their bylaw powers to create public utilities. In the result, a municipal council can disestablish a public utility, whether a

municipal department or autonomous commission, without public consultation and contract or franchise its the operation to a private operator.

Bill 107 appears neutral on whether municipalities should privatize any of their own or OCWA transferred water or wastewater utilities. If grants have been received from the province, the municipality must repay the province before the privatization can occur (see section 3.2.1 full details). But the grants will not be the sole or deciding factor in making the decision. If the municipality is not in a position, financially or administratively, to operate the utility, the decision to privatize might effectively been made for it by the province. For this reason, Bill 107 has the potential to have an immense impact on water customers across the province. What the Bill does not address, however, is why OCWA should be put out of business when there will always be as need for a residual provider for such municipalities.

If municipalities should be fully exploring alternative service delivery options to reduce costs of operation for water customers and taxpayers, it seems imprudent to hamper a low-cost provincial provider like OCWA. Indeed, OCWA already has the capacity to act without provincial government appropriations and can be directed to operate without provincial financial transfers in a competitive service delivery environment. The problem facing OCWA is that it has not been permitted to operate in the businesslike manner that was intended at its creation, even for its residual provider function.

Ironically, the province is seeking on the one hand to give municipalities the powers of a ‘natural person’ to increase their freedom, while on the other it has already given OCWA this power and others like the ability to enter lease-purchase agreements, but has left OCWA constrained by political factors. This is no more evident than in the fact the government, in its wisdom, has chosen to appoint only deputy ministers to the OCWA board of directors, when it could have been appointing a mix of directors, and possibly no civil servants. In this manner OCWA could operate on modern business lines, and with full-cost recovery so as not to burden taxpayers.

The core of this submission provides a detailed analysis of the background and structure of the municipal and provincial water industry, and an assessment of the impact of Bill 26, Bill 86, Bill 107 and the proposed further revision of the *Municipal Act* on Ontario’s water industry.

Part 2. Ontario's Water Industry – *background and structure*

Ontario's water and wastewater industry has been dramatically altered by changes emanating from the Bill 26 and 86 amendments to the *Municipal Act* and the legislative impact Bill 107 will have on the future of the Ontario Clean Water Agency. While these Bills will be reviewed in the next Part, the examination of the water industry's mandate and governance structure in this Part is intended to provide their background. By placing municipal and provincial water developments into the context of the changing character of provincial-municipal relations, this review reveals the municipal side has suffered from statutory neglect and the provincial side has suffered from statutory turmoil.

With origins in 1882, the provisions that govern the municipal water industry barely changed until the passage of Bill 26 and Bill 86 in 1996. Not only are municipal public water utilities generally very poorly equipped for the twenty-first century, but they now are also disadvantaged compared with the private utilities that these Bills make possible. As for the provincial side, the government did not take an active role until the 1950s, but has thereafter continuously laden the industry's business foundation with political and public policy objectives beyond its basic mandate to assist the municipalities with water and wastewater treatment. And despite the creation of OCWA with corporate autonomy from the government, it is subject to an inordinate degree of government policy influence and direct political control, a situation that will increase with the new policy direction and powers for the Minister of the Environment that will result from Bill 107.

The water industry in Ontario, on both the municipal and provincial sides, enjoys an insufficient degree of autonomy from public policy and political objectives extrinsic to its basic mandate. When its concern should be the supply of safe and reliable drinking water that is of good quality, the water industry's business foundation has always been jeopardized by the ability, and sometimes the practice, of municipal and provincial governments to cross-subsidize their other activities through the revenues of the water industry. While the municipal and provincial water industries should operate with full-cost accounting and without cross-subsidization exactly the opposite has been the case. This problem is now compounded by the growing view that government, provincial and municipal, should not be in the water business.

2.1 The Water Industry and the Evolution of Provincial-Municipal Relations

The water industry in Ontario is inextricably linked to municipal and provincial government. Since the provincial government has constitutional jurisdiction over municipal government, the province can statutorily dictate the character of the local water industry. Municipal governments are nonetheless a powerful force in the policy-making for the water industry because they represent local values and sentiments. For these reasons, a full appreciation of the water industry in Ontario requires an understanding of the context in which the provincial-municipal relations exist.

Provincial-municipal relations in Ontario have passed through four eras, swinging back and forth through structural and administrative/financial change. These eras have had important political implications for how the water industry evolved in Ontario. The four eras are: (1) the creation of municipal governments, (2) the establishment of provincial funding and policy control of municipal affairs, (3) the (only partially successful) 'regionalisation' of municipal government, and (4) the present situation, where provincial funding and policy control is faced with adjustment and retrenchment.

During the second half of the nineteenth century, following passage of the *Municipal Act* in 1849, municipal government became the politically convenient means for the provincial government to promote infrastructure spending, and thus a base for economic expansion that did not increase the provincial government's own debt. The direct cost to the locality was the introduction of municipal taxes. The price paid by the province was the creation of financially autonomous municipalities, ones not beholden to the province. It was in this context that municipalities began to establish water utilities. The *Municipal Waterworks Act, 1882*, was a prime example of the province using its statutory powers to facilitate municipal infrastructure spending.

Around the turn of the century, the provincial government came to limit municipal autonomy, in the cause of provincial industrial development objectives and the promotion of uniform municipal services across the province. A growing interventionism on the part of the province, going beyond just facilitating municipal infrastructure spending to providing financial and administrative inducements, arose from technological changes and new economic conditions.

Waterworks stand out as a local service that was subject to only minimal provincial supervision, in this case through the *Public Health Act*. Indeed, water utilities remained local initiatives throughout the second era of provincial-municipal relations. The reason, for the most part, was that they did not require provincial inducement or provincial provision of a service, like water trunk lines. For this reason, water utilities are an important manifestation of local values and expression of local government.

The third phase of provincial-municipal relations was structural like the first, and involved the creation of regional governments, especially in the 1960s and 1970s. Political fragmentation was thought to be an impediment to planning and economic development over larger areas, with regional government believed to be the cure by moving services like water to this new level of government. The province also sought a broader adoption of regional government to promote a rationalization of the number of municipalities in the province, but municipal objections meant this new upper tier was only implemented in twelve jurisdictions.

Although the third area of provincial-municipal relations in Ontario was structural like the first, ironically it was during this time that the province took a concerted interest in the municipal water industry. Decades after providing incentives for roads and other municipal services, it established the Ontario Water Resources Commission in 1956 to assist municipalities in developing water and wastewater facilities. Later still, the environmental significance of these business operations led the government to absorb the OWRC into the newly established Ministry of the Environment in 1972.

The fourth era of provincial-municipal relations consists of the changes currently under way to existing provincial-municipal financial and administrative arrangements. While the changes are motivated by the view that the government performing the service should finance the service and be accountable to taxpayers, they also reflect the view that government is too large and the rules for those doing business with government are too complicated and technical. This new direction in relations will ultimately lead to a reduction in the degree to which there is uniformity of municipal services and water utilities across the province, if any at all.

Uniformity was necessary for early economic development and public health protection, but competition and diversity are now being recommended as a spur to economic development. With financial constraints driving this new political agenda, the future will hold greater autonomy for municipal governments, much like the latter half of the nineteenth century, and thus will undo the provincial political control and regulation that began at the turn of the century.

In this environment, the government has taken action on both the provincial and municipal fronts regarding the water industry. On the provincial front, the government is seeking passage of

Bill 107, with one of the main objectives being to get the Ontario Clean Water Agency, a body with an almost identical mandate to the old OWRC, out of business. On the municipal front, the government has made it easier through Bill 26 and Bill 86 for municipalities to sell off their water and wastewater, utilities to private companies, and Bill 107 will not change this situation. As the remainder of this Part will illustrate, the existence of OCWA is an important service provider that has established a sound business climate for the provincial end of the industry. The downloading of OCWA water and wastewater works to municipalities will be an insufficient response to the challenges facing the local industry in the next century.

2.2 The Municipal Water and Wastewater Industry – *statutory neglect*

The municipal water industry in Ontario has its origins in the first era of provincial-municipal relations, prior to the turn of the century. This is the era when the provincial government wanted municipal governments to establish the local infrastructure necessary for economic growth and expansion in the province. With the end of the twentieth century now approaching, the surprising feature of the industry is how enduring have been the statutory mechanisms that govern the municipal water industry. There was very little alteration to the original outline until 1996.

2.2.1 *Municipal Waterworks Act, 1882*

The statutory origin of the water industry began with the passage of the *Municipal Waterworks Act, 1882*, which permitted municipalities to create water utilities, and notably, extend them into other municipalities under agreement. While the *Waterworks Act* stated that water utilities could be operated by councils or commissions, it was this *Act* which established the provision for three-person or five-person commissions including the head of council *ex officio*. This model for governance actually became the structure for all public utilities, after its provisions were subsumed into the original *Public Utilities Act*, passed in 1913.

When run by commissioners, waterworks did enjoy a level of administrative freedom that did not exist when under the control of councils. The water commissions were to keep their own accounts, submit an annual report to the council, and charge their borrowing against the works constructed. This meant waterworks were structured from the beginning as self-financing entities, and this principle has stood water utilities in good stead for over one-hundred and fifteen years.

The water utility commissions, however, were not fully autonomous from their municipal councils, which retained power to exercise control over all local government affairs. Not only were the waterworks declared the property of the municipal corporation, but the councils were also given the power to pass bylaws governing the administration of the utility, and indeed councils could set the salary of the commissioners, or even could take over a commission. Most important, the excess of revenues over expenses were to be paid over to the council on a quarterly basis. Thus, water utility commissions did not fully enjoy dedicated revenues despite having the power to keep their own accounts, and this has been a problem down to the present day.

There were only three amendments made to the *Waterworks Act* prior to the passage of the *Public Utilities Act* in 1913. The first, in 1887, established popular suffrage as a means for initiating public water utilities. On the petition of electors, the council was required to hold a bylaw referendum, for which only a two-thirds vote of council could stand in the way until the next municipal election could be fought on the issue. The second, in 1890, established that a special levy

for construction of municipal works was permissible. The third, in 1909, was an illustration of their public mandate. It obliged water utilities to supply all public institutions within a municipality, and in 1930 this would be amended to require the same within three miles of the municipality.

2.2.2 *Public Utilities Act, 1913 – joint utility commissions*

The passage of the *Public Utilities Act* in 1913 occurred for a very important and pressing reason. With Ontario Hydro's creation, there was broad enthusiasm for the establishment of municipal public utilities. The new *Act* met this need largely by permitting joint public utilities commissions for two or more utilities. To accomplish this objective, the *Act* subsumed the provisions of the *Municipal Waterworks Act, 1882*, and the *Municipal Light and Heat Act, 1883*. While the enactment did not change provisions specific to the operation of waterworks, it now allowed wastewater works to be operated by a utility commission.

The general provisions of the *Public Utilities Act, 1913* did augment the autonomy of the commissions, however marginally. A commission operating under the *Act* was now given all the powers conferred to municipalities to perform their function, and they were considered to be "body corporate," and thus in law legally distinct from their municipal councils. The financing of each utility with dedicated revenues was enhanced as well with the provision that there were to be separate books and accounts for every utility, presumably to inhibit cross-subsidization among the utilities. This did not, however, change the fact that utilities, save for electric ones, could be used to subsidize other municipal expenditures, a failing of the *Act* that exists today.

Amendments made in 1917 and 1924 were significant for the manner in which they affected the autonomy of water utilities. The first gave them more financial freedom. The excess of revenues after expenses that were to be paid over to the municipal treasurer now had to be applied exclusively to the utility debt, although this provision lasted only until 1944. This new financial autonomy was constrained at the other end in 1924, when municipal councils were given the power to fix their rates by resolution. In 1946, the council power would be limited to setting rates where the existing ones were insufficient.

2.2.3 The *Public Utilities Act* since the Depression

With the arrival of the Great Depression, the *Public Utilities Act* faced some significant amendments in 1931, ones reflective of the economic times. These changes spelled out new avenues for municipalities to dispose of their utilities, or parts of them. However, the sale of all utilities, including water, could only proceed with the assent of electors. The proceeds from the sale had to be applied to the debt of the public utility. Where the proceeds exceeded the debt, the municipality, with the permission of the Ontario Municipal Board, could apply the money to other municipal debt or capital projects. The 1931 amendments, however, also strengthened the provisions that, where commissions exist, the commissions rather the municipal councils are responsible for the administration of the utility. In addition, commissions were now given a new measure of financial authority through the power to appoint their own auditors.

The *Public Utilities Act* was basically left unchanged until well after the Second World War. In 1951, the *Act* was amended to provide that the surpluses of the water utilities were only available to the municipality after stocking a council-authorized reserve fund for improvements and expansion. Since then no significant change to the *Public Utilities Act* occurred until 1996. Filling the vacuum

prior to this change, the provincial government has taken a great interest in the water resources of the province since the 1950s, most recently through OCWA. While this has aided local water and wastewater utilities to perform their functions, these bodies have not been given the statutory modifications that they require to operate as efficient and accountable businesses.

2.3 The Provincial Water and Wastewater Industry – *statutory turmoil*

While the provincial government had concentrated on using municipal governments to establish the water industry in the province from 1882 onwards, it had not abandoned any role for the provincial government. Indeed, two years after the *Municipal Waterworks Act* was passed, the government passed the *Public Health Act, 1884*, for which one of its many purposes was the granting of provincial approvals for municipal water and wastewater works.

The municipal water industry was nevertheless virtually left alone throughout the second era of provincial-municipal relations, the one where financial and administrative arrangements were made for provincial support of local undertakings. This situation changed in the third era, the restructuring of the municipalities after the mid-1950s, when the government created the Ontario Water Resources Commission (OWRC), in effect, to provide the provincial leadership and incentives that had come decades before for other municipal services.

2.3.1 Ontario Water Resources Commission – *creation, 1956*

The primary function of the OWRC, as originally constituted in 1956, was to ensure sufficient development of water supplies and wastewater facilities to meet Ontario's needs in an expanding postwar economy. The OWRC was mandated to pursue these objectives by either developing the facilities on behalf of municipalities or by developing the facilities for municipalities. It could also do the same for individuals. For these ends, the OWRC was given all the powers of a municipal corporation, including the power of expropriation.

In order to perform its functions, the OWRC was given the power to borrow money and provide security. Municipalities were to apply to the commission for services, and initially the contracts did not require cabinet approval. Further, the municipalities were to pay charges to the OWRC that included interest, debt retirement, and operating and maintenance costs. As an aid in fulfilling its primary functions, the OWRC was also given minor policy-oriented subsidiary functions, specifically that of conducting research and building a statistical base for the water industry.

The OWRC's governance structure and financing features were indications that it was an autonomous agency rather than a department of the provincial government. The *OWRC Act* provided for three to five commissioners, and while these were cabinet appointments, the commissioners could hire their own staff outside civil service rules. The *Act* did permit the cabinet to assign a minister to administer the *Act*, and indeed in 1958 that would be none other than John Robarts, a future premier. Instead of mandating that a minister sit as a commissioner, the government chose instead to appoint government backbenchers on an informal basis alongside non-partisan commissioners. For example, John Root was a long-time Conservative backbencher who sat simultaneously as an OWRC commissioner. On finances, it could also make use of a provincial debt guarantee and was assigned the provincial auditor for its auditor, unless the cabinet provided otherwise.

2.3.2 Ontario Water Resources Commission – *policy mandate, 1958*

In 1958 the *OWRC Act* was completely redrafted. While a fuller description was provided for its primary functions, many new responsibilities were also added to its subsidiary public policy functions for water and wastewater works in the province. This further delegation of policy-making to the commission occurred on two levels. The first was the new powers attendant to its existing responsibilities, which now extended to supervision of the operational side of the industry. This included the power to approve all plans, whether the OWRC was involved in the operation or construction of the facilities or not, and to hold hearings on the extension of water and wastewater works from one municipality into another. In addition, the assent of municipal electors for the construction of wastewater works was exempted if the OWRC reported that the facilities were necessary.

The second level was an extension to the OWRC's policy mandate per se. The commission was made the regulatory body responsible for the water supply in the province, which included the power to inspect any municipal facility and to levy fines for polluting water. It was also made the regulatory body that would hear expropriation cases that normally would have gone to the Ontario Municipal Board, and the licencing body for the well drilling industry. The autonomy of the OWRC and the municipalities on water and wastewater was nonetheless narrowed. The contracts between municipalities and the OWRC now required the approval of cabinet.

The *OWRC Act* of 1958 also gave greater detail to the administration of the commission's finances and its agreements with the municipalities. The commission was to establish two consolidated funds, one for reserves for renewal and the other for debt retirement. Both were to be administered by a newly established investment committee, one that did not have to be composed of OWRC commissioners. In order to fund the two consolidated accounts, the levies that the commission could charge the municipalities were given a fuller enumeration.

During the 1960s, the public policy mandate of the OWRC would continually be broadened. In 1960, the commission, with the approval of the minister, was given the power to require industrial or commercial enterprises to have their own wastewater treatment facilities. In 1962, the definition of waterworks in the *Act* was expanded to include all works, rather than just those considered public. And the commission was also given supervisory power over the method of fresh water treatment, which could no longer have additives applied without an OWRC permit.

The long arm of the OWRC was, however, lessened in the case of small waterworks that were not utilized for human consumption. They no longer required OWRC approvals for their plans. The same was true of wastewater works that were not discharged into surface or ground waters. It was at this time, as well, that the debt of a municipality to the OWRC was to be included as part of the overall debt of the municipality, thus giving municipalities less financial breathing room.

In 1964, the OWRC's power to hold hearings on pollution complaints was repealed and replaced with the provision that it could seek a court injunction to prevent the polluting of water. The commission was also given the power to remedy the failure of a municipality or individual to fulfil an order. It could now perform the order itself and charge the cost to the municipality or individual. This directive power was augmented again in 1965 when the *Act* was further amended to permit the OWRC, with the approval of the Ontario Municipal Board, to implement one of its report's findings if a municipality or individual had failed to act on the report.

2.3.3 Ministerial Supervision of Water and Wastewater, 1964

In the meantime, the Department of Energy Resources, created in 1959, was renamed the Department of Energy and Resources Management with its policy mandate expanded to include energy and water resources. While the *OWRC Act* was not amended to leave the agency responsible to the minister, the creation of the new department was nonetheless a signal that the there would be increased ministerial interest in the OWRC's affairs. On other matters, the commission was now permitted to operate on a cost recovery basis for its regulatory approvals. As an indication of the increasing power of the commission, in 1966 it was given the power to define water and wastewater areas, ones that could have their own terms and conditions, and it could terminate or amend contracts according to the new area policy.

With the arrival of a new public sensitivity to environmental issues, as illustrated by the establishment of Pollution Probe here in Ontario in 1967 and the Environmental Protection Agency in the USA in 1969, provincial government policy on water would not be unaffected. Given that it had delegated responsibility for policy to the OWRC, the government had reason to expand the mandate and change the governance structure of the commission in 1970. When this was considered insufficient, it would make new changes in 1972.

In the 1970 instance of change, the *OWRC Act* was amended to extend the supervisory and regulatory power of the commission to all surface and ground water, not just that affecting the water supply. Moreover, the size of the commission was increased to five to eleven commissioners, from three to five. While the amendment also permitted a devolution of authority so that employees could exercise the routine powers of the commissioners, OWRC was nonetheless beginning to lose its overall authority. Public opinion dictated that the minister have increased visibility. As a result, OWRC's power to regulate pollution was changed to permit the commission to do so with ministerial approval, although the commission could still give orders to municipalities or industrial enterprises on water quality.

By 1971, public interest in water quality and the harmful effects of pollution were reaching unprecedented heights, and the Ontario government had to demonstrate appropriate political concern. On the eve of the 1971 election, Bill Davis's first as Conservative premier, the government created the Department of the Environment by giving the existing Department of Energy and Resources Management a new name. But this would not be the end of the changes. In a general reorganization of government in 1972, the government renamed every department a "ministry", and gave to each one the responsibility for all related agencies.

As part of the statutory changes required, the government went one step further with the water industry. In order to give the new environment ministry a critical mass of responsibilities, the government dissolved the OWRC, with its functions now falling directly under the Minister of the Environment. Thus, in the event, the government took control of not just policy-making; the self-financed water and wastewater business activity was moved "on-budget", and thereby subjected to increased and possibly unnecessary political decision-making and scrutiny.

2.3.4 Environment Ministry as Water and Wastewater Operator, 1972

To affect the transfer of responsibilities to the Ministry of the Environment, the *OWRC Act* was renamed the *Ontario Water Resources Act, 1972*. The autonomous commission structure was terminated, with the minister assuming all of the OWRC's powers. This included the delegation of powers to subordinates, and the independent powers of the commission to make agreements and raise financing also were passed to the minister. While the OWRC's investment committee continued to exist to administer the funds in the debt retirement and renewal accounts, it was now subject to the supervision and direction of the Ontario Treasurer. Later, in 1974, the investment committee was dissolved, with the assets it managed placed in the new Ministry of Environment's consolidated debt retirement account and consolidated reserve account.

In place of the hearings and regulatory function of the OWRC, the Environmental Hearings Board was created through further revisions to the *Water Resources Act* in 1974. Like the OWRC, the board was to have five to eleven members, all appointed by the cabinet. And within a year, the conflict that remained between the Ministry of Environment's operational and regulatory functions in the *Water Resources Act* was resolved. All of the hearings board's functions were passed to the new Environmental Assessment Board, created in 1975. Subsequently, the *Water Resources Act* would be amended in 1983 to allow appeals to the Environmental Appeal Board following the establishment of that body.

Not much changed on the provincial side of the water industry until the election of David Peterson's Liberal government, which took a tough stand on environmental pollution. In 1986 it substantially increased all of the *OWR Act*'s penalties and fines, especially for second offences, and created new ones that removed the monetary benefit from polluting. The Minister could also suspend licences, and hold corporate directors responsible. Later still the *Act* was amended in 1988 to change references from "municipalities and persons" to just "persons" in order to leave municipal employees and officers individually responsible. Moreover, government officials were given the power to seize offending materials or instruct that they not be moved. Regarding penalties, the Environmental Assessment Board was also now permitted to fix the cost of a polluting offence, and permit the awarding of costs for a hearing. The *Act* was also broadened to permit objections to hearings and appeals to hearing decisions. The room for appeal, however, was narrowed in 1990 as a result of the Minister being given the power to override an order that had been stayed by the court.

By the late 1980s, a realization was developing that the expansion of the policy mandate of the Ministry of the Environment sat uneasily with the operational responsibility of the Ministry for water and wastewater plants. It was clear that the regulatory and supervisory functions had been expanded at the expense of attention to concern for the ministry's responsibilities for water and wastewater. Treasurer Robert Nixon proposed that the operational side of the Ministry be transferred to a new crown corporation like the old Ontario Water Resources Commission, but cabinet policy disagreements on this matter and the defeat of the government in 1990 stood in the way.

2.4 The Ontario Clean Water Agency – *creation, 1993*

In November 1993, the government created the Ontario Clean Water Agency (OCWA) by hiving off the water and wastewater business operations of the Ministry of Environment. It left in place the policy dimensions in a smaller unit that was amalgamated with the Ministry of Energy to create the Ministry of Environment and Energy. While the change was motivated in part by the government's

desire to improve its financial picture through moving costly items "off-budget", it nevertheless made good business sense for such self-sustaining entities to operate with corporate autonomy from the government.

To facilitate the creation of OCWA, the NDP government of then Premier Bob Rae passed the *Capital Investment Plan Act*, which established the agency along with three other crown corporations. A fourth, the Ontario Financial Authority, was also created to manage the financing for the new crowns and other public bodies in the province. The change was consistent with the character of the current, retrenchment era of provincial-municipal relations.

2.4.1 Ontario Clean Water Agency – *business autonomy*

OCWA's governance structure and objects clearly spell out its business orientation. It is to have a board of four to twelve directors, all appointed by the cabinet, and it enjoys the rights and privileges of a natural person. The primary object of the agency is simply to build and operate water and wastewater facilities for municipalities in its own name or assist the municipalities to build and operate their own. It also has the limited public policy objectives of protecting human health, encouraging conservation, and supporting provincial land use and settlement policies. To achieve these purposes, the agency was given the water and wastewater works of the Ministry without compensation, and by statute the government is prohibited from entering these businesses in its own name.

OCWA was designed to operate on modern business lines, fully removed from the government. Of pre-eminent importance, it is mandated to conduct its business on a full-cost recovery basis, meaning that it is not to receive appropriations unless, for example, the government establishes a subsidy program for a class of municipalities. In addition, OCWA has enhanced operational freedom from the government by holding the debt retirement account in its own name and being able to contract with municipalities without receiving cabinet approval. And to ensure it has the flexibility to operate like other private businesses, it is permitted to sell its assets so it can enter lease-purchase agreements. It can also act with the freedom of a private business by declaring that for a given project it is not an "agent" of the crown, and it can also waive crown immunity. Although it must operate like a private business, it nonetheless has the advantage of the crown's power of expropriation and the power to make its own regulations for the industry under its control.

2.4.2 Ontario Clean Water Agency – *government control*

Despite the emphasis on corporate autonomy, OCWA is subject to numerous mechanisms for government control. Foremost, it was declared, save for the above circumstance, a provincial government "agent". In practice this means that the cabinet can formulate the agency's policy, despite the existence of a board of directors, and the Minister of Environment can review its activities, issue policy directives, and approve all bylaws. In addition, all borrowing must be approved by the Minister of Finance, who can also approve all bylaws that involve debt and equity financing.

Beyond these policy controls, the most important infringement on OCWA's business autonomy is that the Minister of Finance can order the agency to turn over surplus funds to the government's Consolidated Revenue Fund. As well, the latter minister receives the annual report, despite the Minister of Environment being the responsible minister. Less onerous, but a restriction

nonetheless, is the requirement that the agency receive cabinet and Treasury Board approval before creating a subsidiary. OCWA does not have the option of selecting its own auditors, and thus falls under the supervision of the Provincial Auditor.

Appointments also fall to the government, and not just the members of the board of directors. The appointment of the chief executive officer is also a prerogative that the cabinet can exercise. Normally, the appointment of directors would only provide the government an avenue of informal influence. However, to date this has amounted to much more. Both Mike Harris's Conservative government and the former NDP government have appointed four deputy ministers to the board, and the NDP named the CEO. By not appointing directors from outside government, the government has inappropriately ensured itself direct and formal control over OCWA. The appointment of the CEO by the government, rather than by the board of directors, has the same effect**.**

Part 3. Ontario's Water Industry – *since 1995*

While the municipal side of the water industry has received attention through the Bill 26 and Bill 86 amendments to the *Municipal Act* after years of neglect, it has not adequately been retooled for business in the twenty-first century. Instead, it was hurriedly submitted to the prospect of privatization and rationalization without municipal utilities being afforded the same opportunity for improvement in the future. While rationalization may not be incompatible with the improvement of public utilities, the possibility of privatization unfairly pits the hampered structure of the municipal water industry against the claimed advantages flowing from privatization.

These changes reflects the government's desire to move away from supporting uniform municipal services, and is thus characteristic of the fourth era of provincial-municipal relations. This process has the potential to be advanced greatly as a result of Bill 107. By transferring OCWA facilities to the municipalities, the government may be forcing municipalities unprepared to accept or operate the utilities to pursue privatization.

3.1 Bill 26 and Bill 86 *Municipal Act* Amendments

Bill 26 – the *Savings and Restructuring Act, 1996* – was passed in January 1996. Its Schedule M amends the *Municipal Act* and the *Public Utilities Act* in order to change the municipal political landscape in two chief ways. It provides for new, expedited rules for restructuring municipalities and it allows municipalities to change or dissolve "local boards", including water utilities, alone or as part of a restructuring initiatives. There are really only two reasons for dissolving a board: so the municipality can take over the utility, or so a private company can purchase a franchise to operate the utility for the municipality. The provisions for rationalization allow municipalities to present proposals to the minister, and for the minister to create restructuring commissions, although only at the request of the municipality. The broad objective is to facilitate restructuring over large areas, which may include the elimination of a layer of municipal government and changes to the form of representation.

Bill 86 – the *Better Local Government Act, 1996* – was passed in December 1996. It also made major changes to core sections of the *Municipal Act* and the *Public Utilities Act*. The changes are of immense significance to the municipal water utility sector. For example, almost every reference to "assent of the electors" in these Acts – the basis for utility commission autonomy from municipal councils – has been removed.

3.1.1 Dissolving Local Boards

The autonomy that water and public utility commissions have enjoyed from municipal councils has rested in their *Public Utilities Act* base. From the inception of the Act in 1913, they could only be established and disestablished with the "assent of the electors," and the same was true for private utilities under the *Municipal Franchises Act*. With Bill 26, however, municipal councils were permitted to pass a bylaw to override the requirement to dissolve or change water or public utilities commissions, but also made it easier to move sewage to a commission from a department by not require the assent of electors.

While the *Public Utilities Act* still requires that the "assent of the electors" be received to establish a public utilities commission, this provision is much more meaningless now that Bill 86 has removed the requirement even to pass a bylaw to override the provision when seeking dissolve a public utility commission. The result is that there is a higher threshold to establish a public water commission than a private water franchise. The latter only requires a council vote, whereas the former requires a referendum.

The only limitation on dissolving public utilities commissions is in the Minister of Municipal Affairs and Housing's statutory prerogative under Bill 26 to establish regulations on the dissolution of local boards. The Minister can prescribe that the municipality stand in place of the board, can designate classes of boards that cannot be dissolved, and can place limits on the power of the municipalities. On February 2, 1996, the Minister's regulation 25/96 excluded public utility commissions involved in the distribution and supply of electricity from those that can be dissolved, and has since been refined under regulation 214/96 on May 29th. The Minister made it possible for a municipality to assume any of a PUC's powers except electricity. This second group of regulations also established that the council can dispense with the elected nature of the commission and make it appointed at the time of the next municipal election. The only exception here is a PUC that has electricity as one of its functions.

3.1.2 Transferring Services between Municipal Tiers

Short of dissolving a local board, Bill 26 made it possible to pass certain services from the lower-tier to the upper-tier (or the reverse) where the municipalities involved fall under the general provisions of the *Municipal Act* (as opposed to those that have their own statute or fall under a regional government statute). A triple-majority is required, involving the passage of a bylaw by the upper-tier council and a majority of the lower-tier or local municipal councils that represent more than 50 percent of the electors in the jurisdiction of the upper-tier. In cases where the service is moving down, the local municipality that initially passes the bylaw is not included in the calculation of half of the municipalities.

The result of the passage of the triple-majority is that each local municipality must either give up the power to the upper-tier or assume the power from the upper-tier, although by agreement the service can remain with the original provider in a single local municipality. Bylaws on service migration, however, are governed by what is permitted by Ministerial regulation. On May 29, 1996, regulation 215/96 established that water and wastewater services and facilities could be moved to the upper-tier.

3.2 Bill 107 and the Future of OCWA Facilities

Bill 107, now before the legislative committee on resources development, would enact the *Municipal Water and Sewage Transfer Act, 1997*. The main purpose of the Bill would be to give the Minister of Environment and Energy the power to transfer the water and sewage facilities owned in the name of the Ontario Clean Water Agency (OCWA) to municipalities. The secondary purpose of Bill 107 is to relieve the government and OCWA of any obligations to construct, expand or finance municipal water and sewage works that are currently under agreement. The municipal recipient, however, would be able to sell the facilities, subject to repaying the government for any provincial subsidy that

helped construct the works or other water and sewage works in the municipality. The Bill also transfers to municipalities most of the current provincial responsibilities for regulating the construction and use of water and sewage systems.

3.2.1 Ownership Transfer

With the passage of the Bill 107, the Minister of Environment and Energy will have the power to make orders for the transfer of OCWA-owned water and sewage works to municipalities, as well as any other assets, liabilities, rights and obligations. This power only applies to facilities that were completed pursuant to agreements before the *Act* was passed and the transfers must occur before January 1, 2005. This will not, therefore, change the relationship for facilities already municipally-owned, where OCWA simply operates the plants under contract, nor does it preclude OCWA from entering new agreements with municipalities. Both of these factors would suggest that OCWA will still be in business, but as a quasi-private operator and service provider. Moreover, the statutory transfer terms mean that municipalities will inherit OCWA as the operator, both management and employees, at least initially.

The Minister is required to give municipalities nine months' notice for the transfer order of any assets under the Act. Once the notice is given, the affected municipality is allowed six months to make written submissions for the Minister's consideration, and after this six months the Minister is not obliged to consider submissions and in fact can proceed with the implementation of the order. In the event that the Minister and the affected municipality reach agreement on the transfer before this time, the transfer can proceed as well. In cases where there are area water and sewage systems with more than one municipality involved, the works can be passed either to a joint-board of municipalities or other arrangements as the order may specify. To permit the latter, municipalities are given the power for this purpose to own property in other municipalities. Disputes about such matters may also be resolved by application to the Ontario Municipal Board. The Minister can also amend the order any time up until January 1, 2005, for purposes of clarification.

Although the transfer of the water and sewage facilities places ownership with the municipality, Bill 107 provides for OCWA to continue to be the operator of the works, with all agreements in OCWA's name remaining valid until they expire. Both the municipality and OCWA can terminate the operator arrangement on six months' notice, but not earlier than one year after the original transfer of the asset. In addition, a municipality that was obligated to make operating payments to OCWA before the transfer remains obligated to do so as long as OCWA remains the operator. Where there is confusion over what portion of the past payment is for operation as opposed to debt retirement, etc., the transfer order may specify the amount. OCWA's other obligations, such as providing services to parties other than municipalities from the facilities in question, are also transferred to the municipalities, although only for as long as OCWA's contracts with these parties. The Minister, however, can override the obligation in the transfer order, and without compensation to these third parties.

3.2.2 Termination of Provincial Financial Obligations

Bill 107 will also amend the *Capital Investment Plan Act, 1993*, which is the legislation that had hived OCWA out of the old Ministry of the Environment and established the basis for its financing. As a result of the proposed amendments, neither the government nor OCWA will have any financial obligations pursuant to any agreement that was arranged before Bill 107 is passed, save for those

made to contractors. However, this will not preclude either from entering new agreements with municipalities. Where OCWA has obligations to manage the construction or works that are owned by a municipality, the obligations are unaffected.

After receiving the ownership of OCWA water or sewage assets, the municipality is under no obligation to maintain operation of the facility, and indeed can sell it to a private interest or give it to another municipality. The latter could include a local municipality passing title to an upper-tier municipality. In the case of privatization, however, the municipality would be obliged to repay the government for any provincial subsidies to the capital cost of both the works in question and other works in the municipality that were received since April 1, 1978. Repayment does not apply, however, to any subsidy received from the federal government, such as through the infrastructure works program initiated in the aftermath of the 1993 federal election. The Minister is charged with resolving disputes between the province and the municipality, but is only obligated to receive written submissions and is not required to hold a public hearing.

3.2.3 Regulating Sewage System Construction and Use

As with other areas of provincial-municipal relations, Bill 107 also provides for the downloading of current provincial responsibilities, in this case for regulating sewage facilities. In general, the provisions of the *Environmental Protection Act* that place regulatory approval and enforcement with Ministry "Directors" are transferred to municipal councils in organized municipalities. The councils, in turn, are expected to designate an "approving authority" to carry out their new responsibilities for "classified" sewage systems (in Ministerial regulations), which includes powers over prohibitions, operating certificates and permits and orders. The approving authority, for its part, is to appoint qualified inspectors who will have provincial offences officer's powers. In cases where the system has a capacity of 4,500 litres/day, these powers are assigned to the upper-tier municipality, but for these purposes single-tier municipalities (cities and separated towns in old counties) are not included as part of the municipality. Agreements between lower-tier or upper-tier municipalities are permitted, as are agreements for the lower-tier to pass its responsibility to the upper-tier (but not the reverse). The Ministry of Municipal Affairs and Housing (not Environment and Energy) is responsible in unorganized areas, but may designate a board of health or another person as the approving authority.

3.3 Proposed New *Municipal Act*

The government's promised new *Municipal Act* is now at the draft legislation stage and is being circulated with a consultation document for public comment until May 9, 1997. Of the greatest significance is the change that will give municipal councils the powers of a 'natural person' within broad areas of authority. This would be in addition to their bylaw powers. The intention is to make the Act "permissive" rather than "prescriptive", with the result being much greater operational and commercial freedom for municipalities. The government plans to have the new legislation in place for the new councils to operate under when they assume office on January 1, 1998.

This sweeping redesign of municipal government and provincial-municipal relations is the third interrelated component of the government's reform agenda. Besides giving municipalities new operational and commercial freedom, the changes also make detailed assignments of service responsibilities, including water, wastewater and energy, between tiers of municipalities. As a result,

the changes will be accompanied by amendments to make the *Public Utilities Act* and other Acts conform. For this reason, the proposal is of additional interest to water utilities, commissions and PUCs. This will even be true for those municipalities that are part of regional governments, since their governing Acts will be repealed so that every municipality falls under the same general legislation.

3.3.1 Powers of a 'Natural Person'

The stated objective of the *Municipal Act's* redrafting is to end provincial involvement in strictly local issues. To accomplish this objective, the government has decided to grant municipalities the powers of a 'natural person' that they would be able to use within assigned broad areas of authority. The end result will be much greater diversity in the provision of municipal services than the current prescriptive powers have allowed. For example, a municipal that wishes to have a private water utility need only contract for the service from a private provider. In the past, the municipality needed to proceed under the statutory provisions of the *Municipal Franchises Act*. Indeed, a municipality would have had to dissolve its public water commission or PUC by referendum and establish the private franchise by the same procedure. While this process ensured the water customers were fully consulted, the recent demise of the "assent of the electors" provisions in the *Public Utilities Act* and *Municipal Franchises Act* means the municipalities can proceed with no public input or consultation.

Given the broad coverage of public utilities in Ontario municipalities, the provisions for franchising utilities were never called upon to any great extent, and thus were never fully developed to ensure fair play. Since the provisions are in the rudimentary state they were at the turn of the century, when public utilities won the day, the same problem that led to the victory of public over private utilities will now potentially recur. A municipality will be locked into long-term franchising contracts for services with little remedy, wishing it had negotiated a better deal. Moreover, the public will hold the municipal council responsible for this failing. And while the current near uniform operation and ownership of water utilities will likely be a casualty of the greater municipal flexibility under natural person powers, it will be extremely difficult to bring the privatized utilities back under public control.

3.3.2 Bylaw Powers

Municipalities differ from natural persons in that they require governance powers (powers not enjoyed by persons). Municipalities, however, would only be able to use their bylaw powers for regulating their own entities, such as water utility departments and commissions. The private provision of services would be governed by contracts, and thus could not be unilaterally amended by bylaws. Moreover, the bylaws will only prevail within the municipality and cannot be in conflict with federal and provincial laws. But where there is a conflict between the bylaws of the upper and lower-tier municipalities, the bylaws of the upper-tier will prevail.

3.3.3 Assignment of Powers between Municipal Tiers

The ability to utilize the new freedoms outlined depends on whether the type of municipality – lower-tier versus upper-tier or single-tier municipalities – has received the power on an "exclusive" or "non-exclusive" basis. Only single-tier municipalities would enjoy all the powers and no lower-tier municipalities receive any of the powers on an exclusive basis. In two-tier municipalities, the local municipality would only have the new powers when they are not assigned exclusively to the upper-tier municipality and the upper has not yet provided the service.

The assignment of responsibilities between the lower-tier and upper-tier municipalities are complicated for water and wastewater by the existing differential assignment of responsibilities with the various regional governments. The bias, however, is for these services to be universally single or upper-tier responsibilities, but lower-tier municipalities could continue to decide utility matters. For water "production and treatment", all upper-tier municipalities except counties would receive the power on an exclusive basis. For sewage treatment and sanitary sewers, the responsibility would be exclusive where it already is at the upper-tier in regions and would be non-exclusive in the other regions and the counties.

3.3.4 Restructuring Utility Services

What is not addressed in any of Bill 26 or 86 and the proposed *Municipal Act* is any mechanism for water or other public utilities to be merged across single and upper-tier boundaries. As far as can be determined, this can only be done in the context of a restructuring study, and would likely only proceed where the municipalities themselves are merging. Moreover, a municipality will not be given the power to incorporate corporations or guarantee securities. The result might be that private utilities have to be created just to gain the efficiencies from the larger service territories. And even within current upper-tier boundaries, the mergers cannot occur without the consent of the municipalities. All the changes together mean municipalities have been given an extraordinary opportunity to recast the public utility sector.

Part 4. Ontario's Water Industry – *past, present, and future*

As they face the twenty-first century, the municipal water and wastewater public utilities in Ontario have been disadvantaged by statutory neglect and the provincial ones by statutory turmoil. Not only have their needs not been updated for the future, they have not been placed on a level playing field with private sector operators who are in a position to be handed their function. The one problem has in fact led to the other. While the future of OCWA at the provincial end of the water industry has been put in jeopardy by Bill 107, municipal water utilities face dramatic change because of the ability of municipal councils to privatize water systems emanating from Bill 26 and Bill 86 amendments to the *Municipal Act* and the *Public Utilities Act*. And the proposed further revisions to these Acts that would give municipal councils the powers of a 'natural person'.

The principal deficiency of the *Public Utilities Act* is that municipal water utilities cannot operate fully as the self-supporting businesses and do not have the flexibility to operate across municipal boundaries like private sector companies. Where the surplus revenues of public water utilities can be siphoned off by municipal councils to pay for other municipal services, privatized municipal public utilities, on the other hand, would get to keep all of their revenues. This outcome is paradoxical. When operated as a public utility, the business does not enjoy dedicated revenues, although this is essential to the ongoing operational viability of the business. When operated as a private utility, the revenues are not at the disposal of the municipal council, but can be taken out by the private owner for the enrichment of their shareholders or other purposes.

While the existence of OCWA is sound in that the business of water and wastewater were moved "off-budget," the agency was equipped for the twenty-first century has the potential for complications. The government's ability to absorb OCWA's surpluses is the most serious concern, but not the most visible and possibly not the most threatening to its business autonomy. The agency is subject to many avenues for provincial government policy direction. This ranges from the power to approve bylaws through to the issue of directives.

Government enterprises like OCWA should have clearly defined mandates and then be left to operate at arm's-length from the government. Otherwise, their business objectives are compromised by political considerations. The government should only appoint the directors, and should limit the pursuit of its objectives to the informal influence of the appointment power. This does not mean that the government should stack the board of directors with deputy ministers beholden to the government, which is presently the case. In fact, OCWA and the government could benefit from the expertise available from the judicious appointment of outside directors. The government should appoint, at a minimum, a majority of outside directors with a diversity of backgrounds, including two with experience in the municipal waterworks industry. It should also leave the appointment of the CEO to the board. Beyond the minimum, the government should amend the statute governing OCWA to remove the government's policy-making powers for the agency, and until that times should refrain from exercising its prerogatives.

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